

The United States is a nation plagued with deficits. While most of the attention is focused on financial deficits, an even deeper problem is a deficit of trust. A series of surveys by the Pew Research Center finds that trust in the federal government and corporations has been declining and is now at all-time lows.

For more proof, one need look no further than the Occupy Wall Street movement, with its highly visible, if somewhat inchoate, protest of the corporate status quo. This growing deficit of trust for leaders of corporations poses a fundamental challenge to corporate boards. So what can directors do?

Current commentary on best practices has been focused on identifying the loss of “trust” as

establish, as a function of good governance, mechanisms that encourage truth telling at all levels of an organization. The corporate construct that most effectively accomplishes this goal is an organizational ombudsman (ombuds).

Educated Directors

NACD has been a leader in offering a range of opportunities to enhance the performance of directors. In the fall of 2011, the NACD Silicon Valley Chapter, in collaboration with the Rock Center for Corporate Governance at Stanford University, hosted a panel of experts to examine how the presence of a governance ombudsman can shift the corporate climate from one that discourages employees

Building a Culture of Trust from the Ground Up

By James Hostetler and Jon McBride

a problem, with too little attention paid to offering truly effective solutions within corporations. For example, after the recent financial crisis, Congress legislated a whistleblower bounty program as part of the Dodd-Frank legislation. Under final rules issued in 2011, the Securities and Exchange Commission can pay large bounties directly to whistleblowers. Many in the corporate community have criticized the SEC’s implementation of new regulations for undermining compliance. Inasmuch as Dodd-Frank sets up a potentially adversarial relationship between leadership and employees, they are right.

There is a better way.

Boards of directors, with their growing scope of oversight and increasing levels of responsibility to monitor and manage risk, have it within their power to advance a uniquely effective solution—a structure that, crafted properly, can create and foster a culture of trust, candor and accountability, and, in doing so, complement a more commonplace, fear-driven culture of compliance. The basic need is to

from reporting misconduct to one characterized by candor and accountability.

What Is an Organizational Ombudsman?

An organizational ombudsman is an informal channel of communication—independent, neutral and confidential—that is established by the board as a critical building block in a comprehensive system for conflict management. It creates a context that enhances compliance, ethics and risk management. It complements each of these formal functions; it does not compete with any of them.

The ombudsman is an advocate for neither the company nor its employees; rather, it is an advocate for fair process. The Office of the Ombudsman is a safe place for anyone in the company to go for information and guidance concerning any kind of problem. In the Office of the Ombudsman a seasoned professional listens and—all off the record—assists in identifying and clarifying issues, helps develop options for action and coaches the visitor on how to think about and present the issue at hand.



In certain circumstances, if anonymity is waived, the ombuds can act as an informal mediator.

Importantly, above and beyond such individual encounters, the ombuds periodically reports to the board of directors about trends, areas of weakness and emerging problems requiring policy, personnel or other systemic adjustment in the operations of the enterprise.

To ensure that the ombuds function achieves its goals effectively, it is important that it report directly to some combination of the chair of the audit committee, the chair of the board of directors and/or the CEO. Examples of corporations that have established appropriate lines of communication and authority are Tyco International and TE Connectivity, where the charters of the audit committee and ombuds office specifically state the roles and responsibilities of these functions: to seek the fair, timely and impartial resolution of compliance and ethics issues, and to pro-

vide a vehicle for improving processes by sharing best practices and addressing systemic issues company-wide.

So Why Do We Need That?

All well and good, you say as a director, but the company has formal channels of communication: human resources, compliance, ethics, internal audit, the general counsel, a hotline and more. How does this additional capability add value?

Picture for a moment a graphic with the “formal” channels appearing as vertical lines (think silos) across the top of the page. Now draw a horizontal line beneath them. Each of these formal functions above the line is an agent of management, makes policy, enforces policy and keeps records. Now look below the line. This is where the ombuds operates. Providing a foundation under all the formal channels, it creates a context, a culture characterized by candor, trust and accountability, within which

all the formal channels above the line can operate in an enhanced manner.

The ombuds as an informal function is not an agent of management, makes no policy, enforces no policy and keeps virtually no records. And perhaps most important of all, in a legal sense, the Office of the Ombudsman is not a “location of notice” to the corporation. If an individual reveals some sensitive matter to the ombuds, the organization has not been “informed.” Thus there is no automatic need to initiate a formal investigation, which, until the issue at hand has been clarified, may not be necessary and may well be an overreaction to the particular circumstances.

An effective ombuds will make it clear that if the individual who has a concern wants to put the organization on notice, he or she will have to escalate the matter to a formal function. The ombuds acts as a feeder to the formal functions. The ombuds takes the time to facilitate the visitor, to ensure that there is a legitimate problem and to assist him or her in determining which formal function is the appropriate one to approach. Thus when the problem comes to one of the formal channels it is focused; the individual knows why he or she is at that particular formal office, what he or she wants to state and what he or she feels might be a constructive outcome. Again, this feeder function saves the formal functions time and enhances their ability to do a better job of addressing the issues than if there were no skilled ombuds undergirding their efforts.

More specifically, the ombuds as part of a comprehensive conflict management system creates tangible value for the corporation. Studies have demonstrated the efficacy of an ombuds program in terms of money savings, productivity gains, personnel retention, managerial efficiencies, improved communication and morale. Not only does the existence of the ombuds increase the likelihood that a complaint will be reported, but it also enables early resolution of issues and reduces the prospects of expensive litigation. In companies that have studied the cost savings, one simple metric—the reduced use of outside counsel—has more than compensated for the cost of establishing an ombuds office. Assessments conducted by John Zinsser of Pacifica Human Communications, a leading expert on ombuds program performance metrics, demonstrate that for every \$1 invested in the ombudsman function, between \$14 and \$23 of value is ultimately returned to the organization. This is a big win for the bottom line.

What If There Were No Ombudsman?

Think for a moment about the individual who has information or a concern, but who is afraid to speak up. Many recent studies have demonstrated that individuals are reluctant to come forward because they fear retaliation or looking stupid in front of a super-

visor or senior executive. No matter how many formal channels there are to choose from, they remain locked in “dangerous silence” because of the prevailing “culture of compliance” that engenders more fear than trust. In today’s corporate environment, individuals too often view all of the functions above the line as “the police” or shills for management.

In a compelling analysis in an article in the May 2007 issue of the *Harvard Business Review*, “Why Employees Are Afraid to Speak,” James Detert and Amy Edmondson reveal the lose-lose aspect of this phenomenon: Half of the employees fear to speak not only about misconduct, but also about constructive good ideas that would advance the company’s business objectives. The authors conclude that “making employees feel safe enough to contribute fully requires deep cultural change that alters how they understand the likely costs...versus benefits...of speaking up.”

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The presence of an organizational ombudsman provides a base—a Petri dish—to nurture that cultural change, to grow a culture of trust. The simple fact that the board and senior management put in place an ombuds function conveys in a credible manner a message to the entire organization that leadership trusts the employees, welcomes information about potential problems without attribution (so long as there is a trusted intermediary—the organizational ombudsman—to sort the wheat from the chaff), and that it wants its employees to know that they have a mechanism to surface and resolve problems in a manner that is totally nonthreatening to the employee.

Understanding the Whistleblower

Why would anyone consider blowing a whistle in the first place? Think about the culture within which whistleblowing happens. An individual most likely would have to feel trapped, with no confidence that the formal systems controlled by management would give him or her a fair hearing, to resort to the extreme option of becoming a whistleblower. (And, despite all the assurances in the law and otherwise of whistleblower protections, the sad reality, as graphically illustrated in the Ethics Resource Center’s 2011 National Business Ethics Survey, is that whistleblowers often experience adverse consequences when they do come forward.)

Think of conflict resolution as happening within a continuum

from 1 to 15. Whistleblowing happens at about 14 on that continuum, when individuals are near the end of their rope. What if there were a mechanism, at, say, 2 on the continuum, where they could find their voice, be heard and experience a culture of candor and trust? What if there were a safe place to raise difficult issues and get clarity and coaching about what options exist to resolve the conflict? The Office of the Ombudsman offers just such a culture, and gives the employee a safe place to sort out issues while providing an early warning system to the board and management. Issues that never would have seen the light of day surface early and get resolved. Isn't that better than allowing them to fester until they blow up on the front page of *The Wall Street Journal*?

This is a win-win for all parties.

'Don't Let It Happen to You'

So why, you might ask, is not every corporation and its board aggressively implementing an effective ombudsman program? There is recent and dramatic evidence that there is a wide gap in knowledge and understanding of this emerging best practice.

In December, James McRitchie (of CorpGov.net) reviewed Charles Howard's definitive book, *The Organizational Ombudsman: Origins, Roles and Operations—A Legal Guide*, published by the American Bar Association in 2010. McRitchie mused: "With all the advantages such offices offer to corporations, I was wondering why more corporations haven't set up programs."

At the 2011 NACD Directorship 100 program, he posed that very question during a panel focused on whistleblowing and other mechanisms to report and resolve ethical issues, sparking interest in what to many was then a novel concept. Virtually no one there, neither panelists nor members of the audience, had any experience with an organizational ombudsman. McRitchie's observation: "Don't let it happen to you. I expect to hear much more about [the] organizational ombudsman in the future..."

In conversations with corporate directors over the years, the response to the question, "What keeps you up at night?" has often been, "I'm terrified of what I don't know." In this context, if there ever were an argument for a corporation to have an effective organizational ombudsman function, Goldman Sachs might well present one of the most compelling. In March, an executive director at Goldman resigned publicly in an op-ed piece published by *The New York Times*. What if you were a director of Goldman Sachs? What would you have had that executive do with his concerns? How long had he felt that the corporation had lost its way? Did others in the organization share his sentiments?

Had there been an effective organizational ombudsman at Goldman, where he could have safely raised such issues of importance, the ombudsman could have brought them to the board in

a not-for-attribution manner. While we have no way of knowing how the board would have reacted, at least it would have had an opportunity to address the fundamental concerns expressed before they became the subject of an op-ed article.

An even more recent example is Walmart. In late April, *The New York Times* published an investigative article alleging that a cadre of senior officers systematically flaunted the Foreign Corrupt Practices Act by covering up blatant bribery involving Walmart's operations in Mexico. Time will tell what board members knew and when they knew it, but if the allegations prove true, then one of the most successful corporations in the world will have experienced serious reputational damage in circumstances where a number of individuals, had there been a safe place to go, would likely have raised concerns.

Absent the presence of an ombuds to gather information anonymously, report on emerging trends and serve as an early warning system, a corporation faces enormous challenges and costs in engaging in damage control and containment measures.

By way of contrast, when Harvey Golub came on board American Express as the new chief executive in the early 1990s, he looked forward and considered how best the company might avoid problematic issues surfacing to cause brand-damaging scandals on his watch. A committee surveyed the options and recommended on organizational ombudsman. American Express has been well served by its Office of the Corporate Ombudsperson for close to 20 years now.

Today's Opportunity

In the face of unprecedented challenges, the corporate governance community has failed to adequately respond. Corporate directors have an enormous opportunity today to take ownership of this emerging best practice in governance by embedding the organizational ombudsman in the DNA of the corporation. Ultimately, the authority and responsibility to reinvent the corporation to meet the demands and opportunities of the 21st century, do not reside in government, shareholders, executives or the public, though all play important roles. They belong to boards of directors that, as a central feature of discharging their fiduciary responsibilities, can become champions in establishing organizational ombudsmen as advocates for fair process, while providing fertile ground for corporations to grow and nurture cultures of trust, candor and accountability. ■

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